

AAPP 115 ACT ACCOUNTING POLICY PAPER ON INTANGIBLE ASSETS: SOFTWARE

Chief Minister, Treasury and Economic Development Directorate

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1. INTRODUCTION

1.1 APPLICATION

1.1.1 Purpose

This ACT Accounting Policy provides general guidance to ACT Government agencies on accounting for intangible assets, specifically computer software.

This policy is to be read in conjunction with the following:

- > AASB 138 Intangible Assets;
- > AASB Interpretation 132 Intangible Assets Web Site Costs;
- > AASB 13 Fair Value Measurement;
- > AASB 136 Impairment of Assets;
- > Conceptual Framework for Financial Reporting (Conceptual Framework);
- > Financial Framework for the Preparation and Presentation of Financial Statements (Framework);
- > IFRS Interpretations Committee Agenda Decision Customer's Right to Receive Access to the Supplier's Software Hosted on the Cloud (IAS 38 Intangible Assets)— March 2019; and
- > IFRS Interpretations Committee Agenda Decision Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 Intangible Assets) – April 2021.

ACT Accounting Policies are to be read in conjunction with applicable Australian Accounting Standards (AAS). AAS incorporate International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board, with the addition of paragraphs on the applicability of each standard in the Australian environment.

There is no intention that the ACT Accounting Policies will replicate the Accounting Standards or FMA. Consequently, agencies should ensure that they have a thorough understanding of the content of the standards and legislation before reading and applying relevant ACT Accounting Policies.

1.1.2 Application Date

This ACT Accounting Policy applies to the reporting periods beginning on or after 1 July 2022. For agencies whose financial year ends on 30 June, this policy is applicable to financial years ending on or after 30 June 2023. For agencies whose financial year ends on 31 December, this policy is applicable to financial years ending on or after 31 December 2022.

1.1.3 Agencies Covered by this Policy

This policy applies to ACT Government Agencies, that is Directorates and Territory Authorities.

1.1.4 Contact

If you have any questions regarding this Policy, contact the Financial Reporting and Framework (FRF) Branch to provide further clarification. Contact details are listed on the 'Accounting in the ACT' website at <u>https://www.treasury.act.gov.au/accounting</u>.

1.1.5 Application of Policy

Requirements of this policy are included in **bold** text, with un-bolded text being background information/commentary.

1.1.6 Scope

This policy relates to software intangible assets only. All other intangible assets, for example patents and copyrights (not related to software), business combinations, Large Scale Generation Certificates (LGCs), Australian Carbon Credit Units (ACCU) and goodwill are not within the scope of this policy.

Contact the FRF Branch if you have accounting questions relating to intangible assets that fall outside of the scope of this policy.

2. BACKGROUND

Intangible assets are non-monetary assets without physical substance. Due to their nature, there are certain complexities involved in their accounting. In order to recognise an intangible asset, an agency must demonstrate that the item meets the definition and recognition criteria specified in the standards as well as the ACT Government specific capitalisation threshold.



Diagram 1: Elements Required to Recognise an Intangible Asset

*Where an item meets the definition criteria but not the recognition criteria, it is considered to be an 'unrecognised intangible asset'. Refer to the Model Financial Statements for details around disclosure relating to unrecognised intangible assets.

3. DEFINITION OF INTANGIBLE ASSETS

To be recognised as an intangible asset, an item must meet both the general definition of an asset as well as the specific definition of an intangible asset.

Flowchart 1: Steps to Recognise an Intangible Asset



- 1. For assets that do not meet the definition of an intangible asset, they may be recognised as an asset if they meet the requirements of other Australian Accounting Standards, for example, AASB 116.
- 2. In addition to recognising an expense, where the recognition criteria specified in Step 3 or Step 4 are not met, agencies should refer to the disclosure requirements for unrecognised intangible assets.

3.1 GENERAL DEFINITION OF ASSETS

AASB 138 para 8 defines an asset as a resource:

- (a) controlled by an entity as a result of past events; and
- (b) from which future economic benefits are expected to flow to the agency.

3.2 SPECIFIC DEFINITION OF INTANGIBLE ASSETS

An intangible asset is defined as an identifiable non-monetary asset without physical substance (AASB 138 para 8).

3.3 DEFINITION ELEMENTS

There are three key elements in these definitions that need to be assessed to determine whether an item meets these definitions. These are as follows:

- identifiable;
- control over the resource; and
- expected future economic benefits.

3.3.1 Identifiable

To meet the definition of an intangible asset, the software must be identifiable. This is to ensure software assets are distinguished separately from goodwill (AASB 138 para 11). To be considered identifiable, the software should either be separable or arise from contractual or other legal rights (AASB 138 para 12). In order to meet the identifiable requirements, it is the ability to separate the assets, not the intention of the agency to transfer them, which should be considered.

3.3.2 Control

An agency controls an asset if the agency has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits (AASB 138 para 13). Often control is demonstrated by enforceable legal rights, however in certain circumstances an agency may be able to demonstrate control without legal enforceability. For example, control may be demonstrated where an agency, and no other party, has the present ability to direct the use of the resource and obtain the benefits that may flow from it (Conceptual Framework para 4.22). Multiple agencies cannot capitalise the same software asset that is under a single agreement due to the concept of control (Conceptual Framework para 4.20).

The control element is a key consideration in relation to cloud computing arrangements, in particular, Software as a Service (SaaS). Refer to Section 3.4.1 below for further guidance specifically on cloud computing arrangements.

3.3.3 Future Economic Benefits

The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by an ACT Government agency. Future economic benefits is synonymous with the notion of service potential (Framework para Aus49.1). For ACT Government agencies, future economic benefits may also be demonstrated by achieving the agency's objectives of providing goods and services. Assets provide a means for agencies to achieve their objectives. Future economic benefits or service potential is the essence of assets.

Agencies should only recognise intangible assets where the useful life is greater than one year.

The future economic benefits should be reflected by a useful life of greater than one year for all intangible assets. Where a useful life is one year or less they should be expensed when incurred. If they were to be capitalised, the amortisation expense would be equal to the capitalised amount being recognised in the first year.

AAPP 115 – Intangible Assets: Software 3.4 SPECIFIC CONSIDERATIONS

3.4.1 Cloud Computing Arrangements

Cloud computing arrangements are where an agency has the right to access the supplier's hardware, usually through the internet, on an as-needs basis. Cloud computing arrangements can generally be split into three categories as per the table below (i.e. Software as a Service (SaaS), Platform as a Service (PaaS) and Infrastructure as a Service (IaaS). In SaaS arrangements, the agency is accessing the supplier's software, however in PaaS and IaaS arrangements the agency uses their own application software.

Agencies should assess their individual cloud computing arrangements to determine what category they fall into. In order to recognise a cloud computing arrangement as an intangible asset it will need to meet the definition and recognition criteria. In particular, for cloud computing arrangements, agencies will need to demonstrate control over the resource to be able to recognise it as an intangible asset.

Table 1: Cloud Computing Arrangements

	Software as a Service (SaaS)	Platform as a Service (PaaS)	Infrastructure as a Service (IaaS)
Description	SaaS is the full cloud package. In a SaaS arrangement, the software applications an agency (customer) utilises are hosted offsite by the cloud service provider. Data that the agency enters into the software is also stored offsite by the provider. In addition, the provider operates and manages the server and associated infrastructure that the software and data is stored on. It is the provider's responsibility to maintain and upgrade the software and infrastructure. Software applications are delivered over the Internet, on demand and usually via subscription. Users connect to applications over the Internet (via web browser on smart devices or PC).	PaaS refers to cloud computing services that supply an on-demand environment that developers can use to develop, test, deliver and manage software applications. It allows developers to create web or mobile apps without the need to set up or manage the underlying environment and infrastructure (i.e. servers, storage, networks, databases).	laaS allows a customer to relocate its applications to run in virtual servers located within the cloud computing service provider. The supplier hosts and maintains the back-end infrastructure such as servers, storage capacity and networking resources. Where only laaS is purchased, the customer owns and manages everything else, such as the operating system, middleware, data and application software. Customer pays for scalable (can be a fixed or scalable capacity) IT infrastructure from a cloud provider on a pay-as-you-go basis.
	SaaS arrangements are the most comprehensive of the three arrangements, including the infrastructure, operating environment and application software. SaaS = Software + PaaS + IaaS (although they will not necessarily be specified in the arrangement).	PaaS involves the provision of the infrastructure and operating environment. PaaS = Operating environment + IaaS	This is the most basic arrangement where it is only the infrastructure that is provided. The infrastructure is provided without the other services included in PaaS and SaaS arrangements.
Examples	Google Workspace, Adobe Creative Cloud and Office 365 (noting these may still also be offered via traditional software)	Cloud Run, Microsoft Windows Azure (noting they offer a variety of services)	Amazon Web Services, Google Cloud, Microsoft Azure (noting they offer a variety of services)

3.4.1.1 Accounting for SaaS arrangements

The software involved with SaaS arrangements will <u>not meet</u> the definition of an intangible asset of ACT Government agencies due to the lack of control and as such will be expensed in the period incurred.

If a cloud computing arrangement is determined to be SaaS it should be treated as a service arrangement (i.e. a purchased hosting arrangement) as the supplier controls intellectual property of the underlying software. That is, the agency (as customer) is paying for future access to the supplier's software which is hosted on the supplier's cloud infrastructure.

SaaS arrangements have the following characteristics, which prevent them from being recognised as intangible assets due to the agency's lack of control over them:

- the customer cannot take possession of the software at any time during the hosting period without significant penalty. Without significant penalty means the penalty or additional fee to take possession of the software should not be considered significant when compared with the total cost of 'using' the software;
- the agency does not own the intellectual property and cannot restrict others from using it; and
- the customer cannot run the software on their own hardware or contract another party to host the software.

Example 1 – Software as a Service

Agency A has entered into an agreement with Company D for the provision of Software G. In the past, the software was purchased for \$70,000 and was installed on user's computers for three years. This year, the software will not be installed on computers, instead users will access the software through their web browser and Company D will maintain the software and retain the intellectual property (IP).

Analysis:

In order to meet the definition of an intangible asset, Agency A needs to be able to identify the software, demonstrate control and be able to obtain future economic benefits from the use of the software.

In this case, Agency A can identify the software, Software G. Agency A then assesses whether they control the software. As they do not own the IP and cannot restrict use from others, and they cannot take possession of the software and run on their own computers they do not have control. Therefore Software G cannot be treated as an intangible asset by Agency A.

In the previous arrangement, the software was installed on the user's computer and they could restrict use by others, therefore Agency A could demonstrate control. If Agency A could previously demonstrate that they could obtain future economic benefits they may have recognised an intangible asset for the software.

3.4.1.2 Customisation and Configurations

This section is applicable for SaaS arrangements, that is, where the underlying software has been identified to be a service contract and not an intangible asset. For enhancements to intangible assets, not related to SaaS, refer to Section 6.2.4.

An agency may incur additional costs related to a SaaS arrangement, for example configuration and/or customisation costs relating to the software. These costs may be required to modify the agency's existing systems so that the application software can be used or modifying the application software specifically for the agency so that it meets the agency's requirements.

To determine how to account for these costs, agencies should first use the definitions below to determine if the adjustments are a customisation or a configuration. Note that even if a contract refers to 'customisation' or 'configuration' the underlying nature of the adjustments required should be considered against the definitions below as the terms may be used differently.

The following definitions are used when determining the appropriate accounting treatment:

- Configuration is the setting up of the existing software, it does not add any extra functionality but simply prepares it for the agency to use. Configurations do not create a separate asset from the underlying software and therefore would not meet the definition of an intangible asset themselves. These costs should be expensed; and
- Customisation is the modifying of the software to change or add new functionality. Customisation may be performed internally by an agency, by the supplier of the underlying SaaS or by an external third-party provider.

Agencies should undertake an assessment of the customisation services to determine the appropriate accounting treatment.

Customisation costs may be capitalised where they meet the definition and recognition criteria of an intangible assets themselves, even if the underlying software cannot be capitalised. Although all the definition and recognition elements must be able to be satisfied, of particular relevance to customisation, an agency would need to be able to demonstrate that the additional code or software is:

- identifiable the customisations need to be separately identified from the underlying application software;
- controlled by the agency in determining control, it is necessary for agencies to establish whether they:
 - o can take possession of the additional code/software without significant penalty;
 - o can run it on their own hardware; or
 - o own the intellectual property and/or can direct the use of the additional code/software and prevent other parties from using it.

If the additional code/software is produced internally it may suggest that the agency has control, although an assessment would still need to be completed; and

 provides future economic benefits for the agency – the customisation needs to be used over a period of time and provide future economic benefits (noting that these may be achieving the agency's objectives). For example, if additional software is used <u>once</u> to format and migrate existing data to enable the application software to work, it is unlikely to meet this requirement. However, if additional software is used by an agency to migrate data between an existing system and the application software on an <u>ongoing</u> basis then it may be possible to demonstrate future economic benefits for the agency¹.

¹ The purpose of the software in this example is specifically for data migration, therefore the software may not meet the future economic benefits criteria if it will not be used on an ongoing basis. This differs from data migrations costs referred to in Diagram 3 which relate to the data migration costs involved in an internally generated software, where the purpose will generally not be solely for data migration.

In practice, often the agency will not have control of the additional code of customisation software as the intellectual property will remain with the provider or they cannot be separated from the underlying SaaS. Where an agency cannot demonstrate that the customisation is an intangible asset, the costs should be expensed.

Treatment of Costs Assessed to not be an Intangible Asset

If it is identified that the customisation cannot be capitalised as it does not meet the definition or recognition requirements of an intangible asset, agencies will need to consider whether these services are 'distinct' or 'not distinct' from the underlying SaaS to determine the appropriate timing to recognise the related expense. That is:

- Where the supplier of SaaS provides the configuration/customisation and the:
 - customisation is distinct from the underlying SaaS recognise the costs of the customisation as an expense when the supplier customises the application software;
 - customisation is not distinct from the underlying SaaS (that is, the customisation is not separately identifiable from the underlying right to access the application software) recognise the costs of the customisation as an expense when the supplier provides access to the application software over the contract term.
- Where the supplier of the configuration/customisation is a third-party (i.e. not the supplier of the SaaS) the expense should be recognised when the configuration/customisation of the application software is performed.

Note that if the supplier of the configuration/customisation is paid prior to the configuration/customisation occurring, a prepayment (asset) should initially be recognised.

For further information regarding 'distinct' or not distinct' agencies should refer to AASB 15 *Revenue from Contracts with Customers* and AASB 15 related guidance on the Accounting in the ACT Government website: <u>https://www.treasury.act.gov.au/accounting/</u>.

Example 2 – Expense SaaS but Capitalise Customisation

An example of where customisation costs may be considered an intangible asset is where bridging software is required to be created to use the underlying software (which has been assessed as being a SaaS arrangement), and the agency retains the intellectual property and control of the bridging software. It is used on an ongoing basis to migrate data that is held within an existing system to the new SaaS application.

Analysis:

The bridging software should only be capitalised where it meets all the elements of the definition and recognition criteria of an intangible asset.

3.4.1.3 Accounting for PaaS and IaaS arrangements

The software used in conjunction with PaaS and IaaS arrangements (i.e. not in a SaaS arrangement) will generally meet the definition of an intangible asset of ACT Government agencies and if so, should be capitalised.

An assessment of software used with PaaS and IaaS should be performed to determine if it meets the definition and recognition requirements of an intangible asset. When assessing whether an agency controls the software used in a PaaS and IaaS arrangement, the software typically has the following characteristics which demonstrate control:

- tend not to be purchased hosting arrangements;
- the customer can take possession of the software at any time during the hosting period without significant penalty. Without significant penalty means the penalty or additional fee to take possession of the software should not be considered significant when compared with the total cost of 'using' the software; and
- the customer can run the software on their own hardware or contract another party to host the software.

There are additional costs (other than the application software) that are incurred in PaaS and IaaS arrangements. For example, the cost of using a third party's infrastructure (i.e. server), their operating environment software and their security software. These costs should be expensed as they do not meet the definition of an intangible asset.

Note that this section <u>does not</u> relate to SaaS arrangements, refer to Section 3.4.1.1 Accounting for SaaS Arrangements above for guidance on that software.

Example 3 – Expense PaaS but Capitalise Software

Agency A has a PaaS arrangement where an external supplier provides the infrastructure and operating system for the agency, that is, they provide the server, storage and network. The supplier maintains the security and systems software. Agency A owns application software which it uses in the environment provided by the supplier.

Analysis:

Agency A should assess the application software against the definition of an intangible asset. If Agency A can demonstrate control and it meets the definition and recognition criteria of an intangible asset, it should be recognised as such. The costs associated with the PaaS arrangement should be expensed, they do not meet the definition of an intangible asset.

3.4.2 Software under a Lease

Software contracts may sometimes be considered leases, that is, the contract may convey the right to control the use of an identified asset for a period of time in exchange for consideration (AASB 16 para 9). AASB 16 *Leases* provides that a lessee may, but is not required to, apply AASB 16 to leases of intangible assets, other than those described in paragraph 16.3(e) which are to be treated as intangible assets (AASB 16 para 4).

ACT Government policy is that agencies shall not apply AASB 16 *Leases* to intangible assets. Therefore, even where software is under a lease agreement, it should be accounted for under AASB 138 *Intangible Assets* and not AASB 16 *Leases*.

3.4.3 Software as Property, Plant and Equipment

Where software is an integral part of a physical asset, such as hardware, AASB 138 para 4 requires the software to be included as property, plant and equipment (PPE) and accounted for under AASB 116 *Property, Plant and Equipment* rather than as an intangible asset.

Agencies should use their judgment when assessing whether software linked with physical assets should be classified as an intangible asset or as PPE. The key consideration is whether the software is 'integral' to the physical asset. For software to be considered integral, it would mean that the PPE would not function without the software.

The opposite situation, where PPE is integral to software, is not provided for in the AAS and therefore should be treated as separate PPE and intangible assets where appropriate.

Most ACT Government agencies' software is large application software which is generally not integral to the operation of a computer and should therefore be classified as an intangible asset rather than property, plant and equipment.

Example 4 – Software as PPE

Agency A has an MRI machine which requires specific software to function.

Analysis:

In this case, the software is integral to the physical asset, as the MRI machine cannot function in the manner intended, without the specific software. This should therefore be capitalised as PPE under AASB 116.

Example 5 – Software not to be Treated as PPE

Agency A has installed specialised security doors which are capitalised as part of leasehold improvements as they meet the definition and recognition requirements. The agency has also purchased software to be used in conjunction with the doors. Although the software enhances the functionality of the security doors, they are able to function without the software.

Analysis:

In this case, the software is not integral to the physical asset as the doors will still function as security doors without the software. Therefore, the software should not be capitalised as PPE. If the software meets the definition and recognition criteria it should be treated as an intangible asset.

4. INTANGIBLE ASSET CLASSES

A class of software is a grouping of software that have been developed in a similar manner. ACT Government Agencies should categorise their software intangible assets into the following two asset classes:

- Internally generated software; and
- Externally purchased software.

AAPP 115 – Intangible Assets: Software 4.1 INTERNALLY GENERATED SOFTWARE

4.1.1 Definition

Internally generated software has either been:

- developed internally by staff, including where external providers are used to develop the software, specifically for the agency; or
- purchased externally and then significantly modified to meet the agency's requirements.

Judgment will be required to determine what is considered to be 'significantly modified', however the following may be considered:

- the nature of the modifications, including the complexity and amount required;
- whether the product is usually modified for each customer upon purchase, that is, general configurations that every customer purchasing the product requires is unlikely to be considered 'significant'; and
- the cost of the modifications if the modifications represent a large proportion of the total cost (i.e. product purchase price + modifications cost) it may indicate that they are significant modifications.

Where the internally generated software has multiple components/modules, each component/module that individually meets the requirements to be recognised should be accounted for separately.

4.1.2 Phases

Internally generated software is separated into two phases, the research phase and the development phase.

Phase	Definition (AASB 138 para 8)	Treatment of Costs
Research phase	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.	Expense when incurred (AASB 138 para 54) – agency cannot demonstrate that an intangible asset exists that will generate probable future economic benefits at this stage of the project (AASB 138 para 55).
Development phase	The application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.	Directly attributable costs can be capitalised – see below for further details.

Table 2: Internally Generated Software by Phase

Where the project cannot be separated into the two phases, the agency is to treat them all as being in the research phase and they should be expensed (AASB 138 para 53).

Development Phase

The directly attributable costs incurred during the development phase should be capitalised when the agency can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development (AASB 138 para 57).

Agencies should be aware that not all costs incurred during the development phase are considered 'directly attributable'. Directly attributable costs are those which are necessary to create, produce, and prepare the software to be capable of operating in the manner intended by management. Refer to Attachment A for further guidance on which costs to capitalise and which to expense.

4.1.3 When to Capitalise Internally Generated Intangibles

Where it is expected that an intangible asset will be recognised, the associated costs are initially recorded in a 'work in progress' account, until such time that an intangible asset is recognised and the relevant costs are capitalised. If it is determined that an intangible asset will not be recognised, the costs should be expensed in the period incurred. As per the 'Development Phase' outlined in Section 4.1.2 above, the asset should be capitalised when all of the requirements of AASB 138 para 57 are met, generally this will be when the asset is available for use as intended by management. Generally a live testing period would be considered a part of the development phase and therefore capitalisation would occur following the completion of the testing. Agencies should ensure that internally generated software projects are monitored and capitalised when appropriate.

4.1.4 **Development of Web Sites**

A web site developed for internal or external access may be considered to be an internally generated intangible asset. To be recognised as an internally generated intangible asset, it must meet the same definition and recognition criteria as other intangible assets (AASB 138 para 7). The key element in relation to whether a web site can be recognised is the 'probable future economic benefits', as discussed in Section 5.1.1 below.

Web Site Phases	Description (Int 132 para 2)	Corresponding Internally Generated Phase and Treatment (Int 132 para 9)
Planning	Undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences.	Research – expense
Application and infrastructure development	Obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing.	Development – capitalise where directly attributable

Table	3:	Web	Site	by	Phase
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Web Site Phases	Description (Int 132 para 2)	Corresponding Internally Generated Phase and Treatment (Int 132 para 9)
Graphical design stage	Designing the appearance of web pages.	
Content development stage	Creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development.	Development – capitalise where directly attributable (except if developed to advertise and promote an entity's own products and services – this should be expensed as per AASB 138 para 69(c)).
Operating stage	Maintain and enhance the applications, infrastructure, graphical design and content of the web site.	Expense when it is incurred unless it meets the recognition criteria in AASB 138 para 18.

Note that expenditure on the physical assets related to the web site should be accounted for under AASB 116 and the expenditure related to a provider hosting the agency's web site should not be capitalised (Int 132 para AusCF5).

4.2 EXTERNALLY PURCHASED SOFTWARE

Externally purchased software is software that has been purchased 'off-the-shelf', even those which require minor modifications or configurations for the agency. For example, TM1 Reporting Software and HRMS (Chris 21) Payroll software. This class may include licenses where the software has not been specifically developed for the agency. Perpetual software licences (i.e. one-off payment for use of the software in perpetuity) may be considered an intangible asset if it meets the definition and recognition requirements. Non-perpetual software licences (which may be in the form of subscriptions or ongoing charges for the use of the software) generally do not meet the requirements. However, an agency should assess the licences they hold against the definition and recognition criteria, rather than relying on the terms 'perpetual' or 'non-perpetual', to determine the correct accounting treatment.

Example 6 – Classification

Agency A purchases Product D from Company Y, a product that they sell to a variety of customers. For the purposes of this example, assume that it is an intangible asset. Product D requires some minor customisation by Company Y to meet the requirements of Agency A. This is not the case for all customers.

Analysis:

Product D would be considered externally purchased software. The underlying software is purchased as 'off-the-shelf' software and as the customisation is only minor it is unlikely to be considered internally generated software.

Note: The circumstances around each intangible asset would need to be considered when determining whether software is considered internally generated or externally purchased.

5. RECOGNITION CRITERIA

In addition to meeting the definition of an intangible asset, the recognition criteria of an intangible asset must be met before an item can be recognised as an intangible asset. There are two sets of recognition critieria that need to be considered by agencies. These are the standard recognition requirements (below in Section 5.1) and ACT specific recognition requirements (Section 5.2).

5.1 STANDARD RECOGNITION REQUIREMENTS

In addition to meeting the definition of an intangible asset, the following recognition criteria must be met:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the agency; and
- (b) the cost of the asset can be measured reliably (AASB 138 para 21).

5.1.1 **Probable Future Economic Benefits**

Future economic benefits are discussed in Section 3.3.3 above. In order to recognise an intangible asset, AASB 138 para 22 requires that an agency shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

Internally Generated Software

During the research phase (refer to Section 4.1.2), an agency cannot demonstrate that an intangible asset exists that will generate probable future economic benefits (AASB 138 para 55).

The development phase is further advanced and therefore it may be possible for an agency to demonstrate that there is an intangible asset which will generate probable future economic benefits (AASB 138 para 58). Agencies should assess the item against the principles in *AASB 136 Impairment of Assets* to demonstrate probable future economic benefits.

Externally Purchased Software

As per AASB 138 para 25, where an agency pays to separately acquire intangible assets (i.e. the intangible asset is purchased), the probability recognition criteria is considered to be met.

If it is not probable that future economic benefits will flow to the agency, they should be expensed and not recognised as intangible assets. However, as noted above and as per the Model Financial Statements, consideration should be given to disclose information relating to these unrecognised intangible items.

5.1.2 Reliable Measurement of Asset Cost

In order to recognise an intangible asset, the cost of it must be able to be measured reliably. The costs included differ depending on the asset class.

Internally Generated Software

It is expected that generally the costs incurred on internally generated software will be able to be reliably measured through appropriate record keeping and invoicing. Refer to section 4.1 and Attachment A.1. for a list of examples of costs which should be included.

Externally Purchased Software

As per AASB 138 para 26, where an agency pays to separately acquire the intangible assets (i.e. the intangible asset is purchased), it is considered that this cost is reliably measurable as consideration is in the form of cash or other monetary assets.

5.2 ACT GOVERNMENT SPECIFIC REQUIREMENT

5.2.1 Capitalisation Threshold \$50,000

ACT Accounting Policy requires that ACT Government agencies have a capitalisation recognition threshold for software intangible assets of \$50,000.

For internally generated software, the estimated cost at the commencement of the project should be used to determine if it will meet the capitalisation threshold. The software should be expensed in the period incurred where it will not meet the capitalisation threshold. In the case that it falls below the capitalisation threshold, an agency may still record certain assets in the asset register for insurance, internal control and stocktaking purposes, refer to the Director-General Instructions and your agency's internal procedures for details.

Grouping of like Assets:

Where an agency controls a group of like or similar software that individually fall below the capitalisation threshold, but as a group is greater than the \$50,000 capitalisation threshold, the group of software may be taken up as an asset in the Asset Register, rather than being individually expensed.

Where internally generated software has multiple modules, for example it has three separate standalone modules, for the purpose of the capitalisation threshold the modules should be grouped. That is, if the project (for example, Module 1 + Module 2) meet the capitalisation threshold the modules can be capitalised even if the individual modules are less than the capitalisation threshold. They should, however, not necessarily be capitalised as a single asset, they should be capitalised when they are available for use.

Where these conditions are not met, the individual items should be expensed in the period incurred and should not be capitalised as intangible assets.

Example 7 – Grouping Assets – Material Impact to Asset Class

Agency A purchases 400 application software licences at a cost of \$150 each. The current value of externally purchased software reported by Agency A is \$500,000. Agency A has assessed that the licences are intangible assets, in this situation they are not cloud-based SaaS arrangements.

Analysis:

The aggregate of \$60,000 is above the \$50,000 capitalisation threshold and therefore *may* be recorded as intangible assets.

Example 8 – Grouping Assets – Like Assets

Agency A purchases 200 application software licences for Program C for \$150 each. At the same time they also purchase application software licences for Program D for \$150 each, from the same supplier. Program C and Program D are going to be used by the same users, however the two are separate programs that are in no way linked or reliant on each other. Assume the purchase would be considered material to the asset class.

Analysis:

The aggregate payable to the supplier of \$60,000 is above the \$50,000 capitalisation threshold. However, as the two programs are not 'like' or 'similar' assets, as they are different programs, they cannot be capitalised as a group asset. The individual programs do not exceed the \$50,000 capitalisation threshold and therefore the total \$60,000 should be expensed in the period incurred.

6. MEASUREMENT

6.1 INITIAL MEASUREMENT

Intangible assets which meet both the definition and recognition criteria of AASB 138 and the ACT Government capitalisation threshold, should initially be measured at cost (AASB 138 para 24).

For guidance on what should be included in the cost of the intangible assets, refer to Attachment A.

6.1.1 Software Acquired for Significantly Less than Fair Value

Not-for-profit entities that acquire software assets for consideration that is significantly less than fair value should measure the assets at fair value at the date of acquisition (AASB 138 Aus24.1). It is not expected that this will occur frequently. Where there is no active market, and a fair value is unavailable, the carrying value of the software recognised by the transferor immediately prior to the date of transfer becomes its fair value.

In situations where software is acquired free of charge, or for nominal consideration, by way of a Government grant, the agency is to recognise both the asset and the grant at fair value (AASB 138 para 44, AASB 120 para 23). While agencies should follow the requirements of AASB 138, reference can be made to AASB 1058 *Income of Not-for-Profit Entities* paragraph 7 and B2-B11 for guidance on acquiring an asset at significantly less than fair value principally to enable the agency to further its objectives.

Example 9 – Measurement

Agency A receives software from Agency B for \$200,000 due to an agreement (not an Administrative Arrangement Order) between the two agencies. The fair value of the software is \$800,000.

Analysis:

As there is a fair value which can be measured and Agency A acquired the software for consideration that is significantly less than that fair value, AASB 138 Aus24.1 applies and Agency A should recognise the cost of the software as the fair value at acquisition date, that is the \$800,000.

Dr	Intangible Asset	800,000			
Cr	Cash (or Payable)		200,000		
Cr	Contribution of Assets		600,000		
Rec	Recognise receipt of intangible asset for less than fair value (not in an AAO)				
Dr	Cash (or Receivable)	200,000			
Dr	Contribution of Assets	600,000			
Cr	Intangible Asset		800,000		
Recognise transfer of intangible asset for less than fair value (not in an AAO)					

6.2 SUBSEQUENT MEASUREMENT

After initial recognition, AASB 138 para 72 allows software to be measured either using the cost model or revaluation model (fair value after initial recognition).

ACT Government Agencies have the choice to measure intangible assets subsequent to initial recognition using either the cost model or revaluation model. However, as the revaluation model requires a reference to an active market, and an active market is rare for software, it would only be in limited cases that the revaluation model would be used to measure software.

AASB 1049 specifies that when a standard allows optional treatments, the treatment that aligns with Government Finance Statistics (GFS) must be applied. As a result, paragraph AASB 1049 para 14(a) states that assets within the scope of AASB 116, AASB 138 and AASB 140 are to be measured at fair value. The requirements in AASB 1049 are subject to materiality and as such this policy allows ACT Government agencies to value their intangible assets at either cost or fair value as they are not considered material when compared to the total assets at the Total Territory (TT) level and General Government Sector (GGS) level.

In determining whether to measure intangible assets at cost or fair value an agency should consider the following:

- whether asset values are used to make management decisions;
- whether the asset values are used for asset utilisation purposes; and
- the cost of undertaking revaluations of the asset classes

Although agencies may choose to value some asset classes using the revaluation method and other classes using cost, the method chosen for a class of assets must be consistently applied to the entire asset class. Despite this, where the revaluation method is chosen for a given asset class and there is not an active market for all the assets within the class, those without an active market should be measured at cost less any accumulated amortisation and impairment losses (AASB 138 para 81).

Due to the nature and history of intangible assets held by the ACT Government agencies, it is expected that for the majority, if not all, intangible assets covered in this policy will be measured using the cost model.

Example 10 – Measurement

Agency A has two intangible asset classes – externally purchased software and internally generated software. Internally generated software is made up of three agency specific software programs, known as software Program G, software Program H and software Program I. Management requires Program H to be valued at fair value as there is a competitive market and it ensures that management receives the most accurate valuation to be able to make future software decisions. As Program G and Program I are in the same asset class, they must also be measured at fair value, unless there is no active market for those programs.

6.2.1 Residual Value

AASB 138 para 100 requires the residual value of software to be measured at zero unless there is a commitment from a third party to purchase the software or there is an active market (as defined in AASB 13 *Fair Value Measurement*) for the software and its probable that such a market will exist at the end of the asset's useful life.

6.2.2 Useful Life

AASB 138 para 88 allows the useful life of software to be determined as either indefinite or finite, as assessed by the agency. The useful life over which software is amortised should reflect the estimated length of time over which benefits will be obtained from use of the software.

Given the high rate of obsolescence, all software recorded by ACT Government agencies must have a finite life not exceeding ten years but greater than one year. For those with a one year or less useful life, they will not meet the definition criteria and should be expensed in the period incurred.

Intangible assets that arise from contracts should not exceed the period of the contract, but may be shorter depending on the period over which the agency intends to use the asset (AASB 138 para 94).

Where contracts have a renewal clause, the useful life should only include the renewal term(s) where there is evidence to support that the agency will renew without significant costs (AASB 138 para 94), that is, the cost to the agency to renew is not significant when compared with the future economic benefits expected to flow to the agency for the renewal (AASB 138 para 96(c)). Where the renewal cost is considered significant, consideration should be given to determine if a new intangible asset should be capitalised.

The useful life of all intangible assets should be reviewed at least at the end of each financial year and updated where the assessment indicates a different useful life would be appropriate.

Agencies should ensure that any extension to the useful life will not create a useful life of greater than ten years. Agencies should ensure that changes to useful life can be substantiated. Judgement will be required by the agency to determine what will be considered appropriate documentation to support a change in useful life. An example of appropriate documentation could be confirmation from IT specialists regarding the useful life of the software.

Changes in useful life, for example where an agency increases a useful life from five years to nine years, should be accounted for as a change in accounting estimate under AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors. For guidance on accounting for changes in accounting estimates refer to AADP 301 ACT Accounting Disclosure Paper on Accounting for Changes in Accounting Policy and Accounting Estimates and Correction of Prior Period Errors available on the Accounting in the ACT Government website: <u>https://www.treasury.act.gov.au/accounting/</u>. Where an intangible asset is replaced, the useful life for the replacement should be reflected, that is, it will have a new useful life that will need to be identified. Where an intangible asset is enhanced, the useful life may need to be updated but it generally will not be treated as a 'new asset' with a new useful life. Refer to Section 6.2.4 below for further information on enhancements of software.

Example 11 – Identification of Useful Life

Assume the definition and recognition criteria of an intangible asset are met.

Agency A purchases licenses for computer software from Company T. The terms of the contract specify that 500 licenses will be provided for five years, at a total cost of \$100,000. The contract provides for one extension of an additional three years.

Analysis:

Agency A will need to determine if the useful life should be recognised as five years or eight years. Consideration will need to be given as to whether management is expected to take up the extension, whether there is evidence to support this conclusion and whether it can be extended without significant costs. Where it is uncertain whether the extension will be taken up or whether it will require significant costs, the useful life of five years should be used.

An annual review of the useful life should be performed.

Example 12 – Accounting for Change in Useful Life

Assume the same situation as per Example 11, initially whether the extension will be taken up is uncertain and a five year useful life was applied. However, during year three it is decided that it is likely that the extension will be used and there is no significant penalty.

Analysis:

The useful life should be adjusted to eight years.

The change would require disclosure under AASB 108 and the change in accounting estimate would be applied in year three when it is determined that the useful life requires updating.

FY	Opening Value	Amortisation	Closing Value
FY1	100,000	20,000	80,000
FY2	80,000	20,000	60,000
FY3	60,000	20,000	40,000
FY4	40,000	20,000	20,000
FY5	20,000	20,000	0

Initial schedule, assuming amortisation calculated using straight-line method:

Following change in useful life – as it is a change in accounting estimate it is accounted for prospectively and therefore no change is required for FY1 and FY2. From FY3 the amortisation expense is updated to reflect that there is the additional three years useful life.

FY	Opening Value	Amortisation	Closing Value
FY1	100,000	20,000 ¹	80,000
FY2	80,000	20,000	60,000
FY3 (change occurs)	60,000	10,000 ²	50,000
FY4	50,000	10,000	40,000
FY5	40,000	10,000	30,000
FY6	30,000	10,000	20,000
FY7	20,000	10,000	10,000
FY8	10,000	10,000	0

1. Amortisation = opening value / useful life remaining (100,000 / 5) = 20,000

2. Amortisation = opening value / useful life remaining (60,000 / 6) = 10,000

6.2.3 Amortisation

Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life (AASB 138 para 8) and is usually recognised in the Operating Statement as amortisation expense (AASB 138 para 99). Amortisation should only begin when the intangible asset is available for use, that is, when it is in the location and condition necessary for it to be capable of operating in a manner intended by management (AASB 138 para 97).

Amortisation should cease at the earlier of when the intangible asset is classified as held for sale or the intangible asset is derecognised (AASB 138 para 97).

There are a variety of methods available to calculate the amortisation, including straight-line method, diminishing balance method and the units of production method (AASB 138 para 98). The method chosen should reflect the expected pattern of consumption of the future economic benefits and should be applied consistently between periods (AASB 138 para 98). In practise, for most agencies that hold intangible assets, the straight-line method will best reflect the expected pattern of consumption.

Where an agency identifies that another method would be more suitable and requires assistance with the calculation, the agency should contact the FRF Branch.

Example 13 – Straight-line Amortisation

Agency A purchased software Program D in 202X for \$200,000. All the criteria to be capitalised as an intangible asset were met and it was determined to have a useful life of five years.

Analysis:

The annual amortisation would be:

\$200,000 / 5 years = \$40,000 per annum

Dr	Intangible Asset	200,000			
Cr	Cash (or Payable)		200,000		
Initia	Initial recognition of original asset				
Dr	Amortisation Expense	40,000			
Cr	Cr Intangible Asset 40,000				
Recognise amortisation (at end of each year from year 1 to year 5)					

Note: In practise agencies will enter a journal each month to recognise the amortisation expense.

6.2.4 Enhancement of Software

AASB 138 para 18 states that costs incurred in adding to, replacing part of, or servicing an intangible asset, must meet the definition and recognition criteria for those costs to be capitalised.

- Maintenance does not add to the functionality of the software. Costs for maintenance should be expensed.
- Modifications/enhancements should be considered to add to the service potential and functionality of the existing software in future periods, for example, it can perform tasks post-modification that could not previously be done. Costs for enhancements should be capitalised where they meet the definition of an intangible asset and the recognition criteria.

Enhancements should be greater than the capitalisation threshold to be capitalised. ACT Accounting Policy requires that where an enhancement is considered to be so extensive that it constitutes a replacement of the existing software, the enhancement should be capitalised (if equal to or greater than the capitalisation threshold).

Judgement will be required to determine when an enhancement is considered to be so extensive that it constitutes a replacement of the existing software. The following factors should be considered:

- the total value of the enhancements; and
- whether there is additional functionality and whether the current software being used will continue to be used – if the existing software will continue to be used in conjunction with enhanced functionality it may indicate that it is an enhancement rather than replacement.

Where it is identified that there is a replacement of the software, any amortisation relating to the replaced software must be written back against its initial cost and the remaining unamortised amount must be written-off (expensed) in the year that the software is replaced. If the cost of the replacement is less than the threshold, it must be expensed in the period it is incurred.

Refer to Section 6.2.2 for information regarding useful life for enhancements and replacements.

Example 14 – Maintenance

Software program D is classified as an intangible asset and was capitalised at a cost of \$100,000 with a useful life of five years. In the second and fourth year of its use, some of the code is required to be adjusted to ensure it functions correctly. This is a cost of \$10,000 each time.

Analysis:

This would be considered maintenance, the adjustments to the code are not extensive and do not provide for any additional functionality. The \$10,000 should therefore be expensed in the period it is incurred, that is, an expense of \$10,000 in year two and year four.

Example 15 – Enhancement

Agency A acquired an intangible asset for a cost of \$200,000 with a useful life of five years. Following the end of the second year (i.e. at the start of year three), enhancements were performed at a cost of \$60,000. The example below assumes that the definition and recognition criteria of an intangible asset are met for both the original software and the enhancement. The enhancement is not considered to be extensive enough to be a replacement.

Analysis:

Dr	Intangible Asset	200,000			
Cr	Cash (or Payable)		200,000		
Init	ial recognition of original asset				
Dr	Amortisation Expense	40,000			
Cr	Accumulated Amortisation		40,000		
Rec	ognise amortisation (end of year 1 and 2)			
Dr	Intangible Asset (add to original asset)	60,000			
Cr	Cash (or payable)		60,000		
Rec	Recognise enhancement to asset				
Dr	Amortisation expense	60,000			
Cr	Accumulated amortisation		60,000		

Recognise amortisation expense (Year 3 onwards)

Financial Year	Original Carrying	Original	Adjusted	Adjusted
	Value	Amortisation	Carrying Value	Amortisation
		Expense		Expense
0	200,000	-	200,000	-
Y1	160,000	40,000	160,000	40,000
Y2	120,000	40,000	120,000	40,000
Y3	80,000	40,000	120,000	60,000
Y4	40,000	40,000	60,000	60,000
Y5	0	40,000	0	60,000

Example 16 – Enhancement Constituting a Replacement

Agency A acquired an intangible asset for a cost of \$100,000 with a useful life of five years. Following the end of the third year (i.e. at the start of year four), extensive enhancements were performed at a cost of \$150,000. The enhancements are extensive and are considered to be a replacement. The useful life for the replacement asset is assessed to be two years. The example below assumes that the definition and recognition criteria of an intangible asset are met for both the original and replacement software.

Analysis:

Dr	Intangible Asset	100,000	
Cr	Cash (or Payable)		100,000
Init	ial recognition of original software		
Dr	Amortisation Expense	20,000	
Cr	Accumulated Amortisation		20,000
Rec	ognise amortisation (End of Year 1, 2 and	d 3)	
Dr	Accumulated Amortisation	60,000	
Cr	Intangible Asset		60,000
Wri	te-back previously recognised amortisati	on prior to write-	off
Dr	Write-off Expense	40,000	
Cr	Intangible Asset		40,000
Wri	te-off original asset		
Dr	Intangible Asset (replacement)	150,000	
Cr	Cash (or Payable)		50,000
Rec	ognise replacement asset	· · · · · ·	
Dr	Amortisation Expense	75,000	
Cr	Intangible Assot		75 000
Cr	Intaligible Asset		73,000

Financial Year	Original Carrying	Original	Adjusted	Adjusted
	Value	Amortisation	Carrying Value	Amortisation
		Expense		Expense
0	100,000	-	100,000	-
Y1	80,000	20,000	80,000	20,000
Y2	60,000	20,000	60,000	20,000
Y3	40,000	20,000	40,000	20,000
Y4	20,000	20,000	75,000	75,000
Y5	0	20,000	0	75,000

6.2.5 Impairment

In the rare case that software held by agencies is measured using the revaluation model under AASB 138 *Intangible Assets* and regularly revalued, the following section will not be applicable (AASB 136 para Aus5.1(a)). However, the majority, if not all, software held by agencies will be measured at cost and therefore the following section will be applicable (AASB 136 para Aus5.1(b)).

If the economic benefits of the software are unlikely to be realised, they will be subject to impairment (write-down). An impairment loss is recognised where the recoverable amount of an asset is determined to be less than its carrying value (AASB 136 para 59). Where the recoverable amount of an asset is determined to be greater than the carrying value, there is no impairment and no impairment adjustment would be required.

ACT Government Agencies are required to assess software for indicators of impairment at the end of each reporting period.

Software not yet available for use must be tested for impairment annually regardless of whether there is an indicator of impairment (AASB 136 para 10(a)). Impairment testing can occur at any time within the financial year, but it should be completed at the same time each year for those assets. Where software which is not yet available for use is first recognised during a financial year, it must be tested for impairment before the end of that year (AASB 136 para 10(a)).



Flowchart 2: Determine if Impairment Testing is Required

6.2.5.1 Indicators of Impairment

At each reporting date, ACT Government Agencies shall assess whether there is any indication that software is impaired. If no indicators of impairment exist, ACT Government Agencies are not required to make a formal estimate of recoverable amount of the software. An indicator of impairment may also suggest that the remaining useful life, the amortisation method or residual value may also require updating, even if there is no impairment loss recognised (AASB 136 para 17).

There are a number of indicators that software maybe impaired. There are two groups of indicators identified in AASB 136, internal and external indicators. Each group is outlined in the diagram below.

Diagram 2: Indicators of Impairment

External Sources of Information Internal Sources of Information AASB 136 paras 12(a)-(d) AASB 136 paras 12(e)-(g) Observable indications that the • asset value has declined more Evidence of obsolescence. than expected from passage of Significant changes to the entity time or normal use. which will have an adverse Significant changes with adverse impact on the use of the asset effects on the entity or asset have (e.g. the asset becoming idle, taken place, or expected to in the plans to discontinue or near future, in technological, restructure the operation to market, economic or legal which an asset belongs, plans to environment. dispose of an asset before the Market interest rates or other previously expected date, and market rates of return on reassessing the useful life of an investments have increased, and asset as finite rather than they are likely to affect the indefinite). discount rate used in calculating Evidence from internal reporting • the assets value in use and that indicates the economic decrease the asset's recoverable performance of an asset is, or amount materially. will be, worse than expected. Carrying amount of the net assets of the entity is greater than its market capitalisation.

Example 17 – Example of Significant Changes with Adverse Effects on the Software

Agency A uses software Program D provided by Company G. It was capitalised as an intangible asset in 20X2 with a five year useful life. In 20X4, Company G announced that they were developing a new program and support for Program D would no longer be provided.

Analysis:

In this example, an annual assessment would be done in 20X2 and 20X3 to assess whether there are any indicators of impairment and given there were no indicators of impairment it was assessed as not impaired. In the 20X4 assessment of whether there are any indicators of impairment it was determined that there were indicators of impairment as there are technological changes in the market which will have significant adverse impacts on the intangible asset (being the support for software Program D would no longer be provided). The asset would then need to be tested for impairment.

Example 18 – Example of External and Internal Sources of Information

Agency A uses financial reporting software, Software D, it purchased as off-the-shelf software from Company G, for \$500,000. It was acquired in 20X2 and identified to have a useful life of five years. In 20X4 the Australian Accounting Standards Board announced some major changes to accounting standards which would come into effect in 20X5. As a result of these changes, in 20X4 Agency A decided to pursue alternative software options.

Analysis:

In this example, an annual assessment of the indicators of impairment was performed in 20X2 and 20X3 and found no indicators of impairment. There had been no public announcement or discussion around the change in accounting standards and Agency A was successfully using Software D to achieve its goals.

In 20X4, the announcement of the major accounting changes to be implemented in 20X6 provides external indicators that Software D may be impaired. Additionally, pursuing alternative software options may provide an internal indicator that the software will not be used as originally expected and may be impaired.

As a result, Software D will need to be tested for impairment, and even if it is identified not to be impaired, it may indicate that the useful life should be reduced.

6.2.5.2 Impairment Testing

Impairment testing will be required where:

- there are indicators of impairment; or
- the intangible asset is not yet available for use.

In order to test for impairment, the recoverable amount of the asset will need to be calculated. AASB 136 defines recoverable amount as the higher of 'fair value less cost of disposal' (FVLCOD) and its 'value in use' (VIU). There will be an impairment loss where the recoverable amount is less than the carrying value of the software.

lf:	Recoverable amount is equal to the:
VIU* > FVLCOD	VIU
FVLCOD > VIU*	FVLCOD

Table 4: Determining the Recoverable Amount

*There are specific considerations for ACT Government Agencies in relation to their intangible assets which are further discussed in the following sections, however, the value in use will generally be zero for agencies and therefore the FVLCOD, being the higher of the two, would be used.

The concept of materiality applies in identifying whether the recoverable amount needs to be estimated (AASB 136 para 15). For example, if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the agency need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference (AASB 136 para 15).

Impairment testing completed by agencies should be documented as audit evidence.

1. Calculating FVLCOD

FVLCOD is the amount obtainable from the sale of an asset, in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

FVLCOD = Fair value - costs of disposal that have not been recognised as liabilities

Examples of costs of disposal include:

- legal costs;
- stamp duty;
- costs of removing the asset; and
- direct incremental costs to bring the software into a condition for sale (AASB 136 para 28).

For ACT Government Agencies, it is unlikely that their software would be sold and the cost of disposal would typically be negligible.

AASB 13 *Fair Value Measurement* provides that an agency should use valuation techniques that are appropriate for the circumstances, for which there is sufficient data available to measure the fair value and where possible maximise the observable inputs and minimise the unobservable inputs (AASB 13 para 61). There are three valuation approaches, these are the:

- market approach;
- cost approach; and
- income approach (AASB 13 para 62).

For software, as there is generally no active market (AASB 138 para 78) the cost approach will usually be the most appropriate way to determine the fair value. The cost approach reflects the amount that would be currently required to replace the service capacity of the software (AASB 13 para B8). This is also referred to as the 'current replacement cost'. In this approach, the cost to acquire the software is adjusted to reflect the software's present condition, taking technological and economic obsolescence into consideration.

2. Calculating Value in Use

ACT Government Agencies

Most, if not all, software held by agencies are held primarily for their service capacity rather than their ability to generate net cash inflows. As the software does not generate cash inflows, the VIU will have a value of zero, or close to zero. As per above, the recoverable amount is equal to the higher of VIU or FVLCOD. Therefore, where agencies hold software to deliver services to the community, the VIU will generally not need to be calculated as FVLCOD will automatically be the higher value and used as the recoverable amount.

General Calculation of Value in Use

The value in use calculation should reflect:

- (a) an estimate of the future cash flows the agency expects to derive from the software;
- (b) expectations about possible variations in the amount or timing of those future cash flows;
- (c) the time value of money, represented by the current market risk-free rate of interest;
- (d) the price for bearing the uncertainty inherent in the asset; and
- (e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

The estimates of the future cash flows should include:

- (a) projections of cash inflows from the continuing use of the asset;
- (b) projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the software (including cash outflows to prepare the software for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the software; and
- (c) net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.

AASB 136 para 33 requires the cash flow information be:

- reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the software;
- based on the most recent management budgets or forecasts up to a maximum of five years, unless longer can be justified and should exclude cash flows arising from future restructuring to which an agency is not yet committed, or from cash flows expected from improving the software;
- estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified; and
- should not include cash flows from financing activities or income tax receipts/payments (AASB 136 para 50).

Discount rate

The discount rate used to calculate the present value is the pre-tax rate (rates) that reflects current market assessment of the time value of money and the risks specific to the software for which the future cash flow estimates have not been adjusted.

6.2.5.3 Accounting for Impairment Loss

Impairment loss is equal to the amount that the carrying value exceeds the recoverable value. As intangibles are generally held at cost less accumulated amortisation the impairment loss is taken directly to the operating statement as an expense.

Where an asset has been impaired or a previous impairment has been reversed, future amortisation should be adjusted to reflect the revised carrying amount (AASB 136 para 63).

Reversal of previous impairment

Previously impaired intangible assets that have not been derecognised should be reviewed at each reporting date to determine whether a reversal is required, that is, if the asset would still be considered impaired or not (AASB 136 para 110).

The review of previously impaired intangible assets should be documented. If, during the review, indicators that a reversal may be required exist, agencies should estimate the recoverable amount to determine if a reversal of previous impairment is required. It should be noted that it would only be in rare circumstances where a reversal of impairment for software would occur.

Specific external and internal sources of information should be considered to determine if a reversal is required, similar to those listed in Section 6.2.5.1, Diagram 2 above (AASB 136 para 111), but the opposite as agencies are considering the reversal. Note that any reversal should not result in a carrying amount greater than the original carrying amount (AASB 137 para 117).

Example 19 – Impairment Loss

On 1 July 20X2, Agency A purchased software for \$500,000 cost with 5 years useful life. In 20X3 and 20X4 financial years there were no indicators of impairment. However, in 20X5 there were indicators of impairment. The value in use and FVLCOD were calculated as per the table below.

FVLCOD	VIU
120,000	0*

*as software does not generate cash flow then the VIU will be zero or close to zero.

Analysis:

As FVLCOD (120,000) is greater than the VIU (0) it is used as the recoverable amount and is used to calculate any impairment loss.

The carrying value of the asset at 30 June 20X5 is \$200,000 (refer to the table below for calculation):

FY	Carrying value	Amortisation expense
-	500,000	-
20X3	400,000	100,000
20X4	300,000	100,000
20X5	200,000	100,000

As the carrying value (200,000) is greater than the recoverable amount (120,000) there is an impairment loss (80,000).

Impairment loss = 200,000 – 120,000

Dr	Impairment Loss (expense)	80,000	
Cr	Intangible Asset		80,000
Rec	ognise impairment loss		

The carrying amount and remaining amortisation expense also need to be adjusted, as illustrated below.

Financial Year	Original carrying value	Original amortisation expense	Adjusted carrying value	Adjusted amortisation expense	Impairment loss
-	500,000	-	500,000	-	-
20X3	400,000	100,000	400,000	100,000	-
20X4	300,000	100,000	300,000	100,000	-
20X5	200,000	100,000	120,000	100,000	80,000
20X6	100,000	100,000	60,000	60,000	-
20X7	0	100,000	0	60,000	-

6.2.6 Derecognition

Agencies must derecognise intangible assets when:

- they are disposed of; or
- no future economic benefits are expected from its use or disposal (AASB 138 para 112).

For guidance on the derecognition where software has been replaced, refer to Section 6.2.4 (AASB 138 para 115).

In the situation where an intangible asset is not currently used but it has not been fully amortised and is not held for sale, the asset should not be derecognised (AASB 138 para 117). However, in that case, impairment should be considered, refer to Section 6.2.5.

If agencies require accounting advice where intangible assets are disposed of for consideration, please contact the FRF Branch.

Example 20 – Disposal of Software for Nil Consideration at End of Useful Life

For those that are disposed of at the end of their useful life, their carrying value will be zero. That is, it will be equal to the cost less accumulated amortisation and as it is at the end of their useful life and it is policy to have zero residual value, it would be expected that the carrying value is zero.

In that case, no accounting entry is required to recognise the disposal, however it may need to be removed from the asset register, refer to your agency's procedures.

Example 21 – Derecognition of Software Prior to the End of its Useful Life

Agency A recognised software Program D at an initial cost of \$200,000 and a five year useful life. At the end of Year four, as Program D is no longer in use but will not be sold, it is derecognised.

The journals below illustrate the transactions relating to this intangible asset. Note that the carrying value at the date of disposal is recognised as a write-off expense in the Operating Statement.

Dr	Intangible Asset	200,000		
Cr	Cash (or Payable)		200,000	
Initi	ial recognition of original asset			
Dr	Amortisation Expense	40,000		
Cr	Intangible Asset		40,000	
Rec	Recognise amortisation (Year 1, Year 2, Year 3 and Year 4)			
Dr	Write-off Expense	40,000		
Cr	Intangible Asset		40,000	
Derecognise asset in Year 4				

7. ACCOUNTING FOR INTANGIBLES IN STATEMENTS

7.1 PRESENTATION AND DISCLOSURES

For an example and details of disclosure requirements, refer to the Model Financial Statements on the Accounting in the ACT Government website: <u>https://www.treasury.act.gov.au/accounting/</u>.

Where the useful life of an intangible asset has been changed, refer to AADP 301 ACT Accounting Disclosure Paper on Accounting for Changes in Accounting Policy and Accounting Estimates and Correction of Prior Period Errors which is also available on the Accounting in the ACT Government website.

ATTACHMENT A: COST ALLOCATION OF SOFTWARE

As outlined in Section 6.1 above, software is initially recognised at cost. The allocation of costs differs depending on the asset class.

Any costs which have previously been recognised as an expense cannot subsequently be capitalised as part of the cost of an intangible asset (AASB 138 para 71).

A.1 Internally Generated Software

The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management (AASB 138 para 66).

The diagram below provides guidance to ACT Government agencies for determining which costs associated can be capitalised, and which costs should be expensed where an internally generated asset is recognised (that is, it meets all the criteria to be capitalised as an intangible asset). The diagram below does not cover all cost elements incurred in a project. Agencies should consider the particular circumstances around their cost elements and whether they are directly attributable to the software to determine whether it can be capitalised or expensed.

Diagram 3: Allocation of Internally Generated Software Costs

1. Research Phase (Scoping, Evaluation and Business Case) EXPENSE ALL

- Conceptual formulation of alternatives, evaluation of alternatives, determination of the existence of the necessary technology
- Technology evaluation
- Selection of alternatives
- Business case analysis and the management and planning functions for the project
- Developing standards and architectural designs

- 2. Development Phase (Analysis, Design and Development) CAPITALISE ALL
- Detailed analysis of user requirements
- Detailed design and specification
- Software development configuration and interfaces (including total staff costs and contractor/consultant fees)
- Coding
- Installation of software

3. Development Phase (Testing, Production and Implementation) CAPITALISE ALL

- Testing, including parallel processing phase up to the point where the system is live at the first site (only if implementation at subsequent sites does not enhance the software functionality)
- Implementation of the software
 Data migration costs test data used for system testing
- Depreciation of PPE used for development activities (AASB 116.49)

4. Enhancement of Existing Applications CAPITALISE ALL

- Detailed design and specification
- Software configuration
- Development of interfaces
- Coding
- Installation of software on hardware necessary to get the software ready for production (use at the first site only if the implementation at subsequent sites does not enhance functionality)
- Testing
- Parallel processing

EXPENSE 6. Whole of Project, Multi-Stage or Other Items

- Borrowing costs
- Travel costs directly related to the development and the implementation of the IT system
- Development of system specific training material that would be considered part of the asset to be developed and delivered for ongoing business use
- Training staff
- Installation costs at secondary or subsequent sites unless the subsequent implementations require additional analysis, design and configuration to suit meet slightly different business requirements
- Any vendor support costs
- Lease costs for IT hardware
- Ongoing programming support to correct defects or cater for changes in legislation or modified business rules that do not constitute a significant enhancement to the software
- Internal business costs that are difficult to separately identify (i.e. cost of users time spent assisting in the analysis of the business requirements that are not costed directly to the project)

CAPITALISE

- Perpetual software licences acquired to be configured for the new system
- Software licences acquired specifically to develop system, if this software is not expected to be used for any other system development
- Software licences for tools that are expected to be used for a range of projects should be asseted individually and recorded on the appropriate asset register

5. Recurring Maintenance and Infrastructure Support

EXPENSE ALL

- Data migration costs outside of system testing Data (e.g. conversion from old systems into the new system)
- Post implementation review
- Training of staff in the use or administration of the software (training room set up, organising, delivering and, attending training, fees paid to vendor to attend a training course)
- Ongoing support and system administration
- Applications maintenance, including maintenance for software licences which includes provision for delivery of software upgrades
- Management of infrastructure resources and cost of infrastructure support
- Minor projects where an asset will be acquired or developed but the total expenditure will not exceed the threshold amount
- The task being undertaken is unlikely to result in an asset

A.2 Externally Purchased Software

The cost of externally purchased software includes its purchase price and any directly attributable costs of preparing the asset for its intended use (AASB 138 para 27).

Costs incurred after the asset is in the condition necessary for it to be capable of operating as management intended should be expensed and not capitalised as part of the asset (AASB 138 para 30). This is the case, even if the asset is not yet being utilised.

The table below provides guidance to ACT Government agencies for determining which costs associated with externally purchased software should be capitalised and which costs should be expensed (this is only applicable if the project meets the capitalisation threshold).

Cost Item Description	
Expense	Capitalise
 Employee expenses relating to searching, evaluating and selecting the software to be purchased Data migration costs – outside of system testing data (e.g. conversion from old systems into the new system) Training costs Post-implementation maintenance costs Evaluation and assessment costs 	 Purchased software Employee benefits arising directly from bringing asset to its working condition Initial lump sum payment for a license¹ Software installation costs Testing if the asset functions properly Data conversion software cost (develop or obtain), migration costs – test data used for system testing

Table 5: Treatment of Externally Purchased Software Costs

A.3 Illustrative Examples of Cost Allocation

Background

Agency A is creating new accounting software which will comprise of three different modules. The software, known as Software Test, is being internally generated by a mix of employees from Agency A and from an external consultancy firm.

The three modules, Modules 1, 2 and 3 are not expected to be available for use at the same time. The focus has been on Module 1, which can be used as standalone software to meet the initial objectives of the project and is required for Modules 2 and 3 to work effectively. The estimated cost, as per the business case, and the expected completion dates of the various modules are listed below:

Module	Estimated cost (as per business case)	Expected completion date	Expected useful life
1	\$300,000	31/12/20X2	4 years
2	\$70,000	30/6/20X3	2 years
3	\$40,000	30/9/20X3	2 years

There have been a number of invoices received. The Project Manager has ensured that the descriptions on the invoices have been recorded so that the different types of costs can be identified easily. The following are a selection of line items from the Project Manager's workbook:

Inv #	Description	Amount (\$)
-	Module 1 – Employee expenses to evaluate technology options	5,214
3451	Module 1 – Consultant fees to develop initial designs for the Module	16,378
-	Module 1 – Employee expenses to develop software interfaces	21,051
6214	Module 1 – Consultant fees to write software code	25,148
6214	Module 1 – Consultant fees to test software	2,178
6214	Module 2 – Project manager time planning the development of the	1,378
7185	Module 1 – Training on use of software	2,157
7185	Module 2 – Consultant fees to do detailed design	8,145
7199	Module 1 – Post-implementation review	2,782
7199	Module 1 – Development of user procedures	1,500
7199	Module 1 – User support	2,500
7199	Module 2 – Installation of software	4,058
7199	Module 3 – Consultant fees to do detailed design	3,587

There were some project delays and on 1 February 20X3, as soon as it was ready, Module 1 went live. Module 2 was available for use on schedule, however was not utilised by the teams until 1 August 20X3. Module 3 is still in development.

Analysis:

1. Should the software be capitalised?

The following assumes that Software Test meets the definition of an intangible asset, including a useful life greater than one year and the recognition criteria.

Modules 1 and 2 are expected to be greater than the capitalisation threshold of \$50,000 and therefore should be capitalised. Module 3 alone does not meet the capitalisation threshold, however as it is part of the larger project which exceeds the threshold, it should be capitalised (refer to section 5.2.1).

2. Should one software asset be capitalised or a separate software asset for each module?

This will depend on the specific situation. Consideration should be given to the useful life; different modules cannot be capitalised into a single asset where they have differing useful lives.

In the given situation, the modules should be capitalised as separate assets.

3. When should the software be capitalised?

Costs should be recorded in Capital Work in Progress accounts until the software is available for use in the way intended by management, not on the expected completion date or when it is actually used.

In this situation, Module 1 should be capitalised on 1 February 20X3 when it is ready for use. Module 2 should be capitalised on 30 June 20X3, when it was available for use. It is not possible to identify when Module 3 will be capitalised from the information given.

4. Which costs should be capitalised?

The final two columns in the table below identify whether specific costs should be expensed or capitalised and provide an explanation as to why this is the case. Reference should be made to A.1. above.

The table below also provides an example of how an invoice may have some components which can be expensed and others that can be capitalised. It is important that invoices are detailed sufficiently in order to determine the correct treatment of costs.

Inv #	Description	Amount (\$)	Capitalise or Expense	Comment
-	Module 1 – Employee expenses to evaluate technology options	5,214	Expense	Research phase
3451	Module 1 – Consultant fees to develop initial designs for the Module	16,378	Expense	Research phase
-	Module 1 – Employee expenses to develop software interfaces	21,051	Capitalise	Development phase
6214	Module 1 – Consultant fees to write software code	25,148	Capitalise	Development phase
6214	Module 1 – Consultant fees to test software	2,178	Capitalise	Development phase
6214	Module 2 – Project manager time planning the development of the Module	1,378	Expense	Research phase
7185	Module 1 – Training on use of software	2,157	Expense	Not directly attributable
7185	Module 2 – Consultant fees to do detailed design	8,145	Capitalise	Development phase
7199	Module 1 – Post-implementation review	2,782	Expense	Not directly attributable
7199	Module 1 – Development of user procedures	1,500	Expense	Not directly attributable
7199	Module 1 – User support	2,500	Expense	Not directly attributable
7199	Module 2 – Installation of software	4,058	Capitalise	Development phase
7199	Module 3 – Consultant fees to do detailed design	3,587	Capitalise	Development phase

Version	Date	Author	Revision notes
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		Branch	



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